Reputation: Risk of risks

An Economist Intelligence Unit white paper sponsored by Ace, Cisco Systems, Deutsche Bank, IBM and KPMG

About the research

Reputation: Risk of risks is the fourth in a series of reports from the Economist Intelligence Unit's Global Risk Briefing, a research programme targeted at senior executives responsible for managing corporate risk. Alasdair Ross is the author of the report, and Gareth Lofthouse is the editor. The Global Risk Briefing is sponsored by Ace, Cisco Systems, Deutsche Bank, IBM and KPMG.

The research for this paper is based on a survey of 269 senior risk managers, as well as in-depth interviews with executives. The Economist Intelligence Unit bears sole responsibility for the content of this report.

Our thanks to everyone who shared their time and insights in this report.

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Executive summary

Protecting a firm's reputation is the most important and difficult task facing senior risk managers, according to a new report by the Economist Intelligence Unit. In a survey of 269 senior executives responsible for managing risk, reputational risk emerged as the most significant threat to business out of a choice of 13 categories of risk. Fully 84% of respondents felt that risks to their company's reputation had increased significantly over the past five years.

This report, which is sponsored by Ace, Cisco Systems, Deutsche Bank, IBM and KPMG, sheds light on the role of the risk manager in protecting corporate reputation. The findings are drawn from a global survey of senior executives, of which 36% are from companies in the financial services sector. Respondents from 18 other industries also participated in the survey.

The report's main findings include the following:

- **Reputation is a prized, and highly vulnerable, corporate asset.** Reputation is one of the most important corporate assets, and also one of the most difficult to protect, according to executives in the survey. In the Economist Intelligence Unit's Risk Barometer, a regular feature of the risk programme's quarterly surveys, reputational risk emerges as the main concern for the majority of risk managers—ahead of regulatory risk, human capital risk, IT network risk, and market risk and credit risk. This preoccupation with reputational risk stems primarily from the fact that executives now see reputation as a major source of competitive advantage. But changes in the business environment have also made companies more vulnerable to reputational damage, with the development of global media and communication channels, increased scrutiny from regulators and reduced customer loyalty cited as three issues that expose companies to increased reputational risk.

- **Companies struggle to categorise—let alone quantify—reputational risk.** Risk managers are divided on whether reputational risk is an issue in its own right or simply a consequence of other risks. The latter view predominates where there is a tradition of well-structured risk measurement and management. In industries where risk managers feel they have identified the key first-tier risks facing their business, they may be more inclined to consider reputational damage as simply a failure to manage these risks properly. In contrast, in sectors where first-tier risk is less quantifiable they are more likely to see reputational threats as a class in their own right.

- **Compliance failures are the biggest source of reputational risk.** The biggest threat to reputation is seen to be a failure to comply with regulatory or legal obligations. Failure to deliver minimum standards of service and product quality to customers is a close second. The risk that unethical practices in the organisation will be exposed follows closely behind. However, failure to hit financial performance targets scores only modestly. Both labour unrest and environmental breaches are also considered an unlikely source of reputational damage.

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- **SMEs lag behind on reputational risk**. Bigger companies undertake more reputational risk management activities. For instance, four-fifths of respondents from organisations posting revenue in excess of US$10bn have implemented processes for crisis management, compared with just one-half for companies with revenue of US$1bn or below. Only half of SMEs formally monitor external perceptions of their companies, versus 61% of larger companies.

- **The CEO is the principal guardian of corporate reputation**. The CEO is regarded as the individual with primary responsibility for managing reputational risk by most organisations in the survey. The chief executive is pivotal in providing an ethical identify for their companies. They also co-ordinate the response of other senior managers to reputational threats and crises. By contrast, the chief risk officer (CRO) has a more technical role, attempting to quantify threats to reputation and policing systems to make sure that they are properly enforced.

- **Good communication is vital to protecting against—and repairing—reputational damage**. Reputation is ultimately about how your business is perceived by stakeholders including customers, investors, regulators, the media and the wider public. While most companies in the survey regularly monitor the perceptions of their customers, communication with the other stakeholders tends to be more patchy. As a result these companies may be slow to address issues that may sully the corporate image. But good communications becomes even more important once a crisis breaks. Companies that have a communications strategy that enables them to respond quickly and effectively to “bad news”, and which manage issues promptly and openly, often emerge with their reputations enhanced. Those that don't often suffer heavy and, in some cases, irreparable damage.

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Introduction

The most valuable asset in the capitalist economy is not cash, stock or buildings, but trust. This was the case in the days when banks competed with each other to disperse their un-backed notes among an ill-protected public. It is even more so today, with dizzying volumes of assets zinging daily through international financial markets faster than legal confirmation can be provided. Thus, although a shortage of cash can bring a company to its knees, it is more frequently a loss of reputation that deals the final blow.

It is curious, then, that while tools and techniques proliferate for managing monetary risks, the art of protecting reputations is poorly developed and understood. Most respondents to our survey agree that reputation is a primary asset of their organisation, and that the risks facing reputation have grown in recent years. However, they also acknowledge that reputational risk is harder to manage than other sorts of risk, largely because of a lack of established tools and techniques and confusion about who is responsible.

In short, reputation is an increasingly critical asset, but protecting it is one of the risk manager's toughest jobs. Why? To start answering this central question, a definition of reputational risk needs to be established. The most popular is some form of the following:

Reputation declines when experience of an organisation falls short of expectation.

But this apparently straightforward description hides a wealth of subtlety.

- Whose experience? An organisation's reputation resides with a wide range of interested parties. Most important are the customers and investors, who between them provide the wherewithal that allows the organisation to function. At a second tier, regulators are key, setting and enforcing standards. Employees' motivation feeds into productivity and service quality, and they are the human face of the organisation. The general public may be affected by the organisation's actions, directly or indirectly, and may respond unfavourably if they feel their interests to be prejudiced. These groups are neither mutually exclusive nor independent of each other. Indeed, the feedback mechanisms between them require special attention from the guardians of reputation.

- What experience? The face that an organisation shows varies from stakeholder to stakeholder. Employees focus on pay and work conditions, and on the availability of training and opportunities for advancement. Such matters are only loosely correlated with the quality of service provided to customers. The experience of the latter may come via an intermediary—a retailer or business partner, for instance—whose own standards of delivery impinge on the impression formed by the customer, potentially to the detriment of the organisation. Investors may be focused more closely on shareholder value than on the quality of service being provided to customers, two factors that once again may be correlated only loosely. The regulator, meanwhile, may be scrutinising the organisation to ensure from a compliance perspective. In all cases, there may be a difference between what the organisation does and how its actions are

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perceived. Reputations are as vulnerable to perceptions of failure as to failure itself.

- Which expectations? If a stakeholder's experience of the organisation falls short of expectation, it will downgrade its opinion. But how were these expectations formed? Were they unrealistic to start with? Did they reflect factors beyond the organisation's control, created perhaps by price-gouging competitors or by shifting social attitudes to matters such as environmental protection and equitable trading practices? Is an organisation being castigated because the sector in which it operates is under a cloud, or because it is being associated with a lawbreaking peer? Organisations may be punished not because of any failure on their part, but simply because they are being held to the wrong standard.

All these considerations greatly complicate the task of those whose responsibility it is to build, maintain or repair reputations. The responses to our survey, and the anecdotal evidence we have gathered, suggest that although risk managers are aware of the threats, their responses vary widely from sector to sector, and from firm to firm.

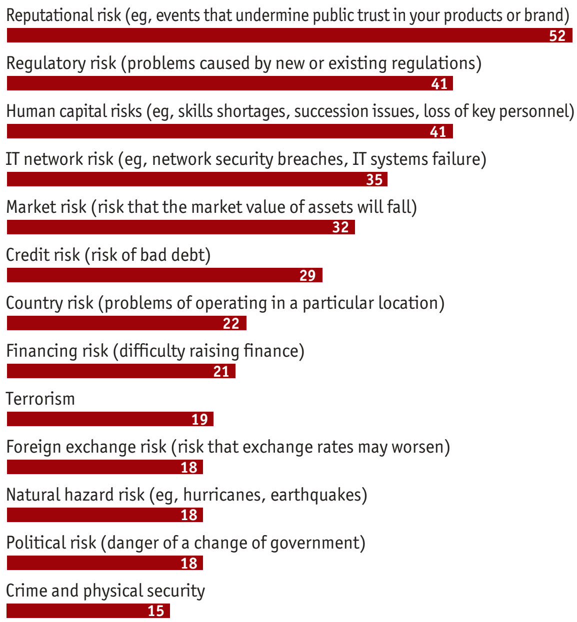
Priority No 1

Respondents to the regular Risk Barometer section in the survey place reputational risk clearly at the top of risk managers' list of priorities. With an index score of 52, reputational risk is perceived as substantially more significant than regulatory risk and human capital risk, both of which score 41. IT network risk, which comes next, scores 35, while the risk management staples of market risk and credit risk score a modest 32 and 29, respectively.

The picture this paints is that regardless of how reputational risk is defined it stands at the forefront of business concerns. There is less agreement on how it should be addressed, or even whether it exists as a separate issue at all. The division between those respondents considering it a category of risk in its own right and those who view it as arising from a variety of other risks is virtually half-and-half. Nevertheless, most companies in the survey see reputational risk as a problem in need of its own, special solutions. Roughly three-quarters of companies disagree with the statement, "A well-run business doesn't need to invest extra resources into guarding against reputational risk."

Ian Beale, risk manager at Aegis plc in London, focuses on reputation and on the perceptions of investors, clients and employees, but does not manage reputation as a specific risk. "We concentrate on the root causes," he says. "If these are managed

How significant a threat do the following risks pose to your company's global business operation today?
(index score, where 100 = highest)



Source: Economist Intelligence Unit, 2005

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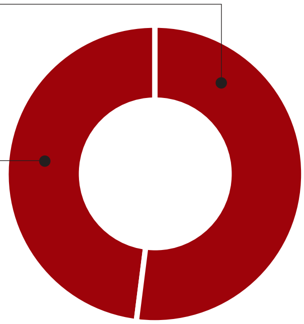
Do you view threats to your company's reputation as:
(% respondents)



Source: Economist Intelligence Unit, 2005

well, then hopefully our reputation stays where we like it." Aegis is a media group, whose companies are engaged in everything from traditional media to Internet and billboards, as well as media research.

Mr Beale finds it a "struggle" to think of what additional actions could be taken that are not already covered by good overall risk management. However, he emphasises that Aegis does spend time and energy making sure that the perception of the company is good. "We carefully consider who says what," he says, and thought is given to the potential impact of actions on clients and employees. Since other executives describe these activities as the fundamentals of reputational risk management, it appears that much of the confusion here arises simply from definitions.

Doug Gafner, director of risk management at Hilton Hotels, considers reputational risk to be "more about getting everything else right" than a unique issue. Hilton, for example, does not buy brand risk insurance, even though it is one of most trusted brands in the US.

At the other extreme comes Dr Guruswami Raghavan, professor of finance at the SDM Institute for Management Development in Mysore, India. "Reputational risk is the starting point for all risk," he explains. "If you have no reputation, you have no business."

Reputation is not just a question of how an organisation is perceived, but of how it is perceived relative to peers and competitors. For the world's only widget supplier, quality may have little bearing on

Regulation meets reputation

Our survey respondents are more or less unanimous in considering that reputational risk has risen sharply in recent years.

The reasons are many. High-profile market failures such as those that brought down Enron and Worldcom are part of the story. "Regulators are regulating more", says Mr Damasceno at ABN AMRO, pointing to the increasingly intrusive role of those charged with policing the proper functioning of the market economy. "The intentions are good: it is an attempt to exorcise the decline of corporate values and to improve the public trust in corporate business and the market economy."

But has the pendulum swung too far? For Mr Mander of Bank of Ireland Securities Services, the answer is an emphatic "yes". The unforgiving focus on failures to meet standards is forcing organisations to dedicate valuable resources to protecting reputation, rather than on establishing relationships with clients and customers that are sufficiently flexible to overcome occasional shortfalls in service. "The marketplace will eventually realise that over-emphasis on individual risk issues is an inefficient way of dealing with them, and place more emphasis on bilateral relationships," he says.

He blames over-zealous regulators. "A lot of what we're doing is driven by regulatory requirements rather than best practice," he explains. However, he acknowledges that with new measures such as the Basel II revised international capital framework still in the pipeline, it will be some time before the pendulum reverses its swing.

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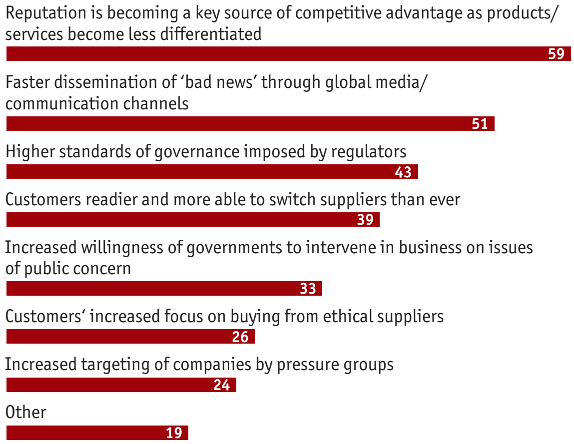
sales. However, such reputation-proof corners of the market exist only in text books. Thus, maintaining reputation is as much a matter of competitive position as it is of individual standing.

Our survey clearly reflects this competitive environment. Respondents identify the growing role of reputation as a source of competitive advantage as the factor most likely to focus management attention on reputational risk. The development of global media/communication channels as a disseminator of reputationally sensitive information is rated second. The regulator comes next, with the imposition of higher standards of governance in the wake of the high-profile market failures of the past decade. Customer power—their readiness to switch supplier—is fourth in the list, ahead of governments' greater propensity to intervene in defence of the public interest.

"It's a buyers' market," says Derek Mander, head of finance & risk management for Bank of Ireland Securities Services. "In the past, if we failed to meet our service standards, we would sit down with clients and reach a solution. Now, clients are more likely simply to change service provider."

How large an impact is each of the following factors likely to have in prompting an increased focus on reputational risk within your company?
(% respondents, large impact, index score, where 100 = highest)



Source: Economist Intelligence Unit, 2005

Secondary hit

Individual types of risk may hit certain business divisions or operations, but each has the potential to cause secondary damage to reputation--and this can easily prove more damaging to profits and shareholder value in the long run.

Failure properly to control credit risk will result in defaults, which will bear a financial cost and deplete capital. However, the perception that an organisation is unable to manage such risks can plant doubt in the minds of its partners, clients and regulators, diverting potential business elsewhere and eliciting a more intrusive and more costly regulatory stance. In the extreme, such doubts can fuel a self-fulfilling fear among depositors that their assets are not secure, sparking bank runs that can quickly wipe out institutions.

The potential of relatively minor failures of risk control to rebound on reputation means that, at the very least, risk managers must be aware of how an event might damage the company's image. But these issues may also require a specific response. Many kinds of risk, in addition to the narrow threat they pose to the business operation, have a reputational element that must be managed separately, whether by managing stakeholder expectations via corporate communications or by establishing processes for quickly addressing crises when they arise.

In some areas, the reputational aspect of a specific risk can be the predominant threat, and recognising this may call for a tougher response than might otherwise have been adopted. For instance, when selecting business partners or, in the case of a bank, major depositors, due diligence should weed out those

whose financial backgrounds suggest an unacceptable likelihood of business interruption or default. But it may also uncover unsavoury facts about the potential partner, which, although not reflecting directly on their financial health, reveal a character with which the organisation may prefer not to be associated.

The business of choosing your trades is familiar to Nedia Miller, owner and founder of Miller CTA, a commodities trading adviser specialising in “crude oil and all the products”. In designing hedging strategies for major clients there is broad scope for unethical behaviour. “I’ve given up large clients rather than cross the line and risk my reputation,” she says. “The financial cost [of legal sanction] is high, but the opportunity cost [of losing business because of a bad reputation] is even higher.” In this context, Ms Miller believes in the importance of personal ethics in protecting a firm’s reputation. New rules and guidance introduced since Enron’s collapse may help in the short run, “but unless there are ethics, it won’t work for long”.

The relationship with stakeholders is in itself a potential source of business failure. This is reputational risk pure and simple, and managing it implies both an awareness of how stakeholders feel about the organisation and a capacity to respond when the feedback is bad. Judy Larkin, director and co-founder of Regester Larkin, a consultancy specialising in reputational risk, emphasises this aspect. With a “more intrusive media organisations must focus resources and time” on monitoring their environment.

In short, black-and-white descriptions of reputational risk as either discrete or dependent miss the point. In general, reputational risks can be viewed as independent in their effect on the organisation, but dependent in that reputational damage usually reflects a failure to deliver products and services as promised. There is also scope for managing reputation as a separate facet of the organisation, by surveying stakeholder opinion and adjusting the corporate message to address shortfalls.

Ethical business

Two fairly recent developments in the business environment, customer demand for ethical products and the rising influence of pressure groups, came at the end of the list, but in both cases are thought to exercise a high impact by at least one-quarter of respondents. The latter may be of some encouragement to a couple of groups whose activity revolves around the growing importance of reputation: the ethical investment market and the NGOs seeking to enforce ethical governance.

Among the former is Wayne Hawkins, a board member of Hunter Hall, a pioneering ethical investment firm based in Australia. His main interest is in safeguarding the company’s own good name. “An ethical fund manager lives or dies by their reputation,” he says.

For pressure groups, the challenge is to put the values of specialised funds such as Hunter Hall’s into general practice. The point is made by Craig Bennett, head of the Corporate Accountability Campaign at Friends of the Earth, a UK pressure group. “The potential of socially responsible investment is probably overdone. It is more interesting to see how mainstream investing is getting more responsible,” he maintains. In this, he believes the trends are firmly in favour of the activists. For instance, he identifies a growing realisation that more environmental regulation and legal obligation is on the way. “It is a train that is coming.” Companies that are ahead of the trend, the “forward thinkers”, will be the beneficiaries.

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School for scandal

A decade ago, faced with a financial squeeze that threatened its survival, Carleton University in Ottawa picked a strategy designed for a quick increase in enrolments, the main pillar of which was to lower entry requirements. It was not subtle: “We took students that probably would not have made it into other universities,” says Tony Lackey, manager, risk and insurance. The institution picked up the nickname, “Last-chance U”.

Enrolments responded, and funding, a function of student numbers, rose accordingly. But problems quickly emerged. Although first-year lectures were stuffed, attendance soon dropped off. The financial problems persisted, and now the University was saddled with an unenviable reputation into the bargain.

The first challenge was one of recognition: “We asked students why they weren’t coming to Carleton,” writes Mr Lackey. It quickly became obvious that the institution’s poor reputation was putting off the better candidates.

Once the reputational problem had been added to the risk matrix—it immediately rose to the top of the list in the annual report prepared for senior management—the remedies were more straightforward. “We raised entry levels and worked to turn ourselves into a research-intensive institution. We concentrated on attracting more funding and higher-level faculty,” Mr Lackey says. The students that did make it in were better treated. Student services—everything from food to buildings--was revamped.

The University is now clawing its way back up the national rankings—and reputational risk has fallen from first place to third on the annual risk report.

The Carleton case is a study in what happens when the reputational aspects of a strategic decision are not properly understood. “We were in financial trouble and we went downmarket,” explains Mr Lackey. “Nobody had tied the reputational impact into funding.”

The cost of reputation

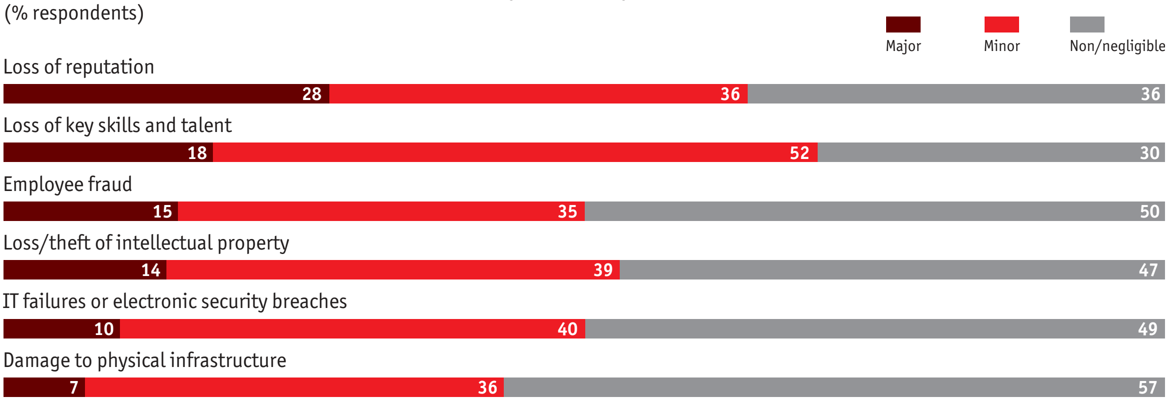
Whether organisations are altogether comfortable with modern definitions of reputational risk, there is little doubt about the potential costs of failure to get to grips with it. Companies found reputational problems to be the most costly in financial terms, relative to a series of other risks. Among those who had faced reputational problems, 28% described the financial toll as major. Loss of key skills and talent, the next most severe problem, caused a major financial hit for only 18% of those affected (although it is worth noting that 52% identified this as a source of minor losses, making it the leading cause of financial losses among the sample overall).

The results reflect the manner in which damage to reputation can be more costly than the direct impact of the events that caused it. “The conventional areas of risk are like the visible part of an iceberg,” says Dr Raghavan. “Reputational risk is the larger part below the surface.”

On the other side of the coin, those looking for investors are likely to find good reputation a key factor in attracting suitors. “Confident investors will pay a higher price for a piece of the action,” says Jonathan Clare, chief executive at Citigate Dewe Rogerson, a London-based public relations company specialising in financial and corporate communications. “If companies get their PR right, it will reduce the cost of capital.”

Once again, there are some interesting sectoral variations in the survey. Although financial services and energy sector responses closely mirror the general pattern, others differ from it substantially. For instance, more than one-third of government/public-sector respondents identified loss of key skills and personnel as having resulted in major financial losses (and a similar number as having caused minor losses). Among this group, reputational damage had been the

How much damage have the following events inflicted on your company's financial performance in the past?
(% respondents)



result of major losses for only one-tenth. Since there is little reason to suppose that public organisations incur less reputational risk than private ones, the implication is that they are less susceptible to reputational damage. In professional services, reputational damage is the biggest single cause of major financial loss, but loss of key skills and personnel runs it a far closer second than in the general sample.

Danger points

For most risk managers, it is the failure to comply with regulatory or legal obligations that represents the biggest threat to reputation. This is supported by the relatively prominent position of the regulator as a driver of board-level focus on reputational risk, indicated above. Second on the list of potential sources of reputational damage is failure to deliver minimum standards of service and product quality to customers—although the gap is small. The risk that unethical practices in the organisation will be exposed is placed third, once again by a narrow margin. Security breaches figure quite prominently, as do failures of crisis management and risk by association with third parties.

Failure to hit financial performance targets scores only modestly. Given the importance of investors among organisations' stakeholders, and the focus in modern investing on shareholder value, the relatively lowly position of meeting market expectations appears odd. It may reflect the fact that organisations perceive this to be a financial risk rather than a reputational one, although modern risk management theory would suggest that they should consider the reputational facet of financial performance more seriously.

The anecdotal evidence is that many do, and that share price is perceived as a key way of gauging the value of reputation. Mr Mander of Bank of Ireland Securities Services points out that the bank is particularly vulnerable to anything that depresses the share price. It has escaped the consolidation of the sector so far, but a reputational crisis would leave it "wide open to takeover".

At the lower end of the scale, it is more interesting to look at the weight of respondents identifying reputational impact as minor. This suggests that, in general, both labour unrest and environmental breaches are considered unlikely sources of reputational damage.

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The list of priorities changes when results for the financial sector are separated out from the rest. Regulatory and legal non-compliance receive particular emphasis from financial organisations, presumably reflecting both the intensity of sectoral regulation relative to other industries and the key role that legal compliance plays in popular perception of banks, pension funds, insurance companies and the like. Standards of service sink to fourth place for this sector, below both exposure of ethical practices and security breaches--again, public trust in honest service appears to be the key, rather than public perception of the quality of that service.

In contrast, those in other sectors place the risk of failing to deliver minimum standards of service and product quality to customers as the principal threat to their reputations. Failure to comply with laws or regulations is a rather distant second, closely followed by the exposure of unethical practices. Towards the bottom of the list, non-financial sector respondents score environmental breaches as a minor threat to reputation—but, as would be expected, give it more emphasis than financial sector respondents.

Do these conclusions support the proposition that reputational risk management is an issue distinct from simply ensuring that the first-tier risks are properly covered? Only to a point. Although first-tier risk issues predominate in the list, a couple with a more direct impact on reputation are prominent among managers' concerns. On the one hand, the importance of being perceived as ethical, in particular, is arguably more a reputational issue than one of fundamental risk management. On the other, one of the issues most closely associated in the public mind with reputational standing, being seen to address issues of public concern such as climate change, is relegated to the bottom of the list of priorities.

Crisis management or crisis prevention?

Reputation is a dynamic asset, changing as organisations present new services and products in new markets, being held to changing criteria and facing unforeseen challenges. This suggests that there is a role for risk managers both in maintaining and protecting the organisation's standing with its stakeholders, and in repairing its good name when events conspire to damage it (see box: How to manage a crisis).

It is the latter that receives most attention from risk managers, with 64% of respondents saying they plan and document processes for crisis management. However, monitoring perceptions also figures prominently, with 53% reporting that external

To what extent are the following actions a source of reputational risk for your organisation?
(% respondents)

Source: Economist Intelligence Unit, 2005

How to manage a crisis

What should a company do when faced with bad news that could hurt its reputation?

If a crisis has already broken, there is not much room for manoeuvre. First, according to Ms Larkin of Regester Larkin, the company needs to “fix the problem” that caused the reputational issue. At the same time, it needs to “communicate very quickly”. This communication must have three elements, or three “C”s:

1. Concern—the company has to acknowledge that something has gone wrong and express regret and concern.

2. Commitment—it must express a commitment to fix the problem, and lay out in detail what it will do.

3. Control—if the company is at the centre of a major crisis, the leading figures in the company need to show that they are in control of the situation and are working with any relevant authorities to ensure it won’t happen again.

Companies “have limited time” to start this communication, otherwise other organisations will assert their own agendas. If they can communicate quickly, those running the business may get stakeholders to give them the benefit of the doubt and have time to do something about the problem.

“If the reality is bad, it’s essentially a matter of making people important to the company understand the issue, and to demonstrate that the company is listening”, says Jonathan Clare of Citigate Dewe Rogerson. “Then you have to convince customers and investors that you have a solution to the problem.”

Mr Jackson of Fordham University summarises it thus: “Be humble, disclose, apologise, resolve to change things, be systematic.” He advises above all against treating the problem as a cosmetic issue, which people will immediately see through. He warns that “[superficial change] makes people even more angry”.

Ragnar Lofstedt, professor of risk management at Kings College London, takes a more strategic approach. “The response depends on the nature of the threat,” he says. “You need to judge how much trust the public has in you and in your attacker.” If you are trusted more, he suggests, fight back. He believes that levels of trust are the key, rather than the details of the case.

perceptions of the company are regularly measured. Once again, in the vein of preparation and early warning, 50% train their employees to identify and manage reputational risks (a low number, considering the prominence all respondents give to the issue) and 47% systematically track reputational threats.

The most revealing split in these responses is according to the size of the organisation. Not surprisingly, there is a general trend for those with more revenue to undertake a greater number of these activities: 80% of respondents from organisations posting revenue in excess of US$10bn have implemented processes for crisis management, compared with just 53% for sub-US$1bn companies (although in both cases this is the most widely employed strategy).

Monitoring outside perceptions of the organisation appears to be something of a luxury, with 61% of the bigger organisations carrying this out, compared with 51% of the smaller organisations. GE Healthcare is one such company, large in its own right but also a subsidiary of a true global giant. This is reflected in the breadth of its efforts to monitor and manage stakeholder perceptions. “We monitor how the organisation is perceived with stakeholders, we lobby, we establish relationships with the media, and we advertise our philanthropic efforts,” reports Steven Kay, the company’s process and crisis manager.

The company’s diversity and size give it an important role in major disasters such as the hurricanes that hit the US Gulf coast and the Asian tsunami. The diversified group can supply a range of vital supplies and services, such as fresh water, power and medical equipment. These are opportunities for

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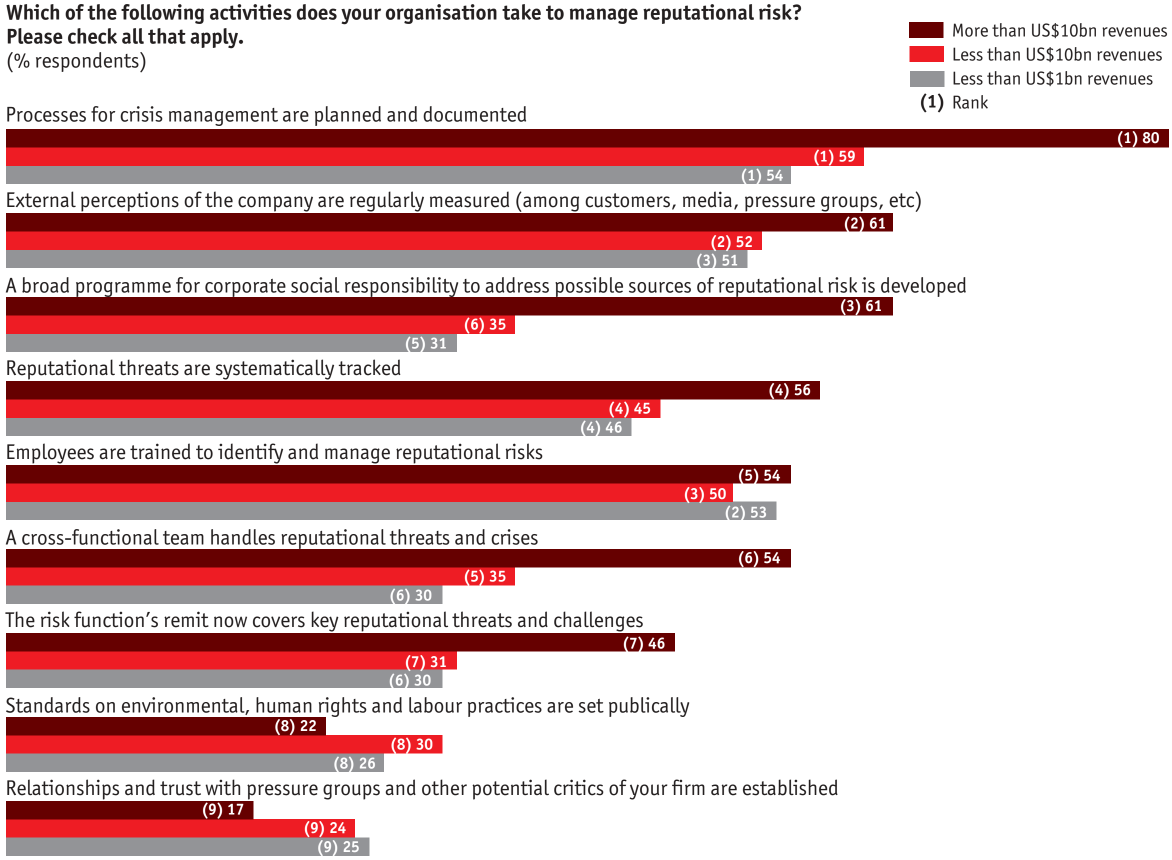
the company to be seen in the best light, but these operations must be undertaken carefully, since they could be construed as exploiting misfortune to gain business advantage—having the opposite reputational effect to that desired.

This focus on perception is where many companies fall down, according to Ms Larkin. “Perception is the biggest threat to reputation today,” she says. She says that you can be doing everything right, but if people don’t think you are you still have a problem. Ms Larkin is “surprised that some [business] sectors still don’t acknowledge the impact of public perception”, and therefore pay insufficient attention to reputational risk management.

Another big international firm with a sharp reputational focus is Hilton Hotels, where according to Mr Gafner “everyone is thought to have something to do with reputational risk”, and that responsibility for protecting the firm’s good name runs from the CEO down.

However, even among the largest firms the intangible nature of reputation and the factors that affect it mean that risk can never be fully mitigated. As Kevin Jackson, professor of business ethics at New York’s Fordham University, puts it: “You are never going to be able to please everybody.” Mr Jackson,

Which of the following activities does your organisation take to manage reputational risk? Please check all that apply.
(% respondents)



Source: Economist Intelligence Unit, 2005

author of a book, Building Reputational Capital, points to the example of HB Fuller, a large US-based manufacturer of adhesives and other chemicals. The company worked hard to build a reputation for corporate responsibility, but nevertheless took a big hit a decade ago for not seeming to do enough about glue sniffing in Latin America.

Among smaller firms, no strategy is pursued by substantially more than one-half of respondents, while, among the larger, only three are carried out by less than one-half.

A typical example of a firm seeking out a strategy for managing reputational risk is Gulf Finance House BSC, based in Bahrain, that offers Islamically structured financial services for regional investors. The bank did not have a risk management strategy at all until 18 months ago, when it appointed Silvan Varghese as head of risk management. At the time, protecting the bank's reputation was considered a matter for the communications function. Mr Varghese's team is now looking at managing such risks more systematically.

A consultant is being taken on to benchmark the current risk status. "We're identifying where we stand with stakeholders, including banks, regulators, customers and shareholders," says Mr Varghese. "Then we'll assess how to address areas of weakness, and how to manage a crisis should it arise."

Mr Varghese takes a crumb of comfort from the knowledge that he is not alone in his quest for a reputational risk management strategy. "We all feel more comfortable with tangible risks that we can count," he says.

Interestingly, in light of popular perceptions of the modern risk environment, companies of all sizes agree in the low priority they give to buzz issues such as establishing relationships with pressure groups and setting out public standards on environmental, human rights and labour practices. In both cases, these strategies appear at the bottom of the list, attracting one-quarter of respondents or fewer--an observation that would come as no surprise to Mr Bennett at Friends of the Earth.

Matter of opinion

When it comes to reputation, all opinions matter, but do some matter more than others? Our survey suggests strongly that they do.

Of all respondents, 60% test the perceptions of customers at least quarterly, and 40% say they do so continuously. Only 4% say that they have never taken the pulse of customer opinion. Regulators' views are also sought relatively frequently—at least quarterly by 51%, although only 23% say they continuously survey regulator opinion. The influence of the media on organisations' reputation is also recognised, with 58% saying they test opinion among this group at least once a year.

Beyond these groups, there is more grist for Mr Bennett's mill. Political activists are ignored by 46% in our sample, although 32% consult them at least once a year. Local and international NGOs are also sidelined, ignored by 32% and 42%, respectively. Once again, however, a substantial minority do seek out their opinion on a regular basis.

Again, sectoral splits reveal some interesting variations. Customer opinion is generally given the highest priority, but this is not the case in the energy sector, where the powerful influence of regulators sets a premium on their views of the organisation. In this group, 45% continuously monitor regulator opinion, and a further 35% do so at least once a year. Customers and government are next on the list, but political activists and NGOs are consulted rarely, if at all.

In the financial sector, customers and the regulator are polled systematically—at least once a year by 80% in the case of the former and by 75% in the case of the

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latter. But the frequency of monitoring varies sharply, with customers courted more assiduously; 45% of respondents say they monitor customer opinion constantly, but only 26% monitor the opinion of the regulator.

Who's in charge?

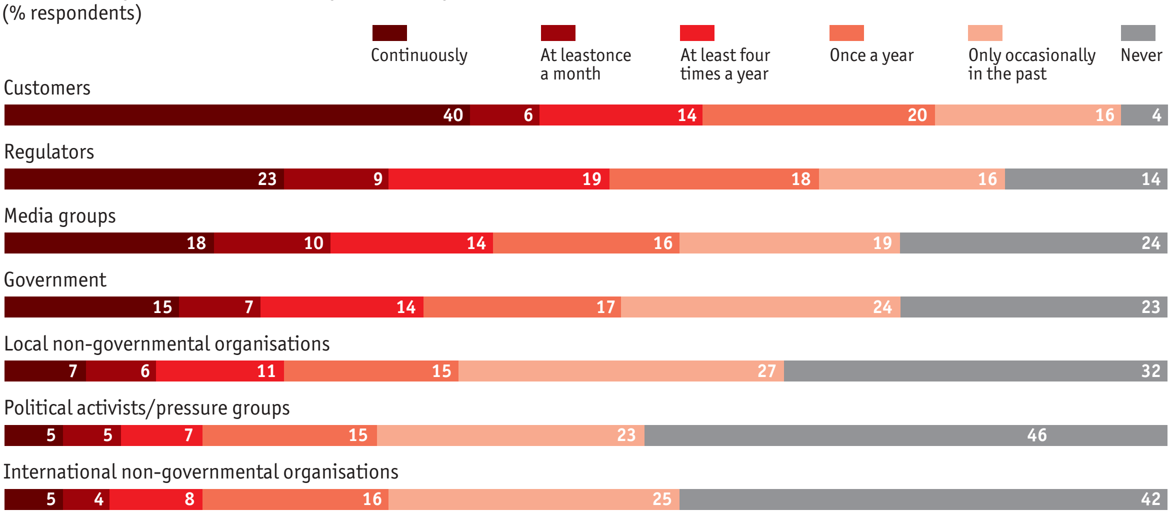
If reputational risk lies somewhat apart from quantifiable first-tier risks such as credit risk, market risk and network risk, is there a danger that it is disregarded, and whose job is it to ensure that that does not happen? Asked to locate responsibility for managing reputational risk, respondents give a clear picture of the hierarchy.

At the top of the reputational risk team is the CEO, cited by 84% of respondents as the person with primary ownership of this area. Companies appear to believe that only the chief executive can take ultimate responsibility for ensuring that all parties are working in unison to protect reputation and manage crises. The CEO is also charged with sensing external perceptions of the organisation, a role backed up by the communications function. Interviewees also emphasised the importance of the CEO's role in setting the right tone and standards of conduct to protect and enhance the company's reputation.

Responsibility is also shared more broadly among the board of directors as a whole, but only by 42% of respondents. Only 39% of respondents identify the CRO or head of risk management as bearing major responsibility. Significantly, the heads of business units are given equal weighting. In contrast to the CEO's role, the CRO's chief area of responsibility is a more technical one, focused on attempting to quantify threats to reputation and policing systems to make sure they are properly enforced. This is an obvious enough division of labour according to expertise. As Ken Akoundi, senior vice-president for risk management (CRO) at Optima Management in New York, puts it, "A lot of these senior people do this more based on years of experience than on a model or framework. My job is about creating the framework."

So far, the division of responsibility suggests a

How often do you test perceptions of your company among the following corporate stakeholders?
(% respondents)



Source: Economist Intelligence Unit, 2005

strategy that is directed towards the organisation's own operations. But what about managing outside perceptions and dealing with stakeholders? The appearance of the communications manager at fifth place on the list, picked out by 35% of respondents, suggests that this angle is not the primary focus for most organisations.

These effects are particularly marked when organisations are split by income. Those with revenue of US$1bn or below and US$10bn or above share similar hierarchies (although the latter give a greater role to the CFO), but the selection among higher earners of multiple options is far more widespread. This implies, as to be expected, that bigger companies spread responsibility for reputational risk more widely, and more extensively at lower levels of seniority, than the smaller companies.

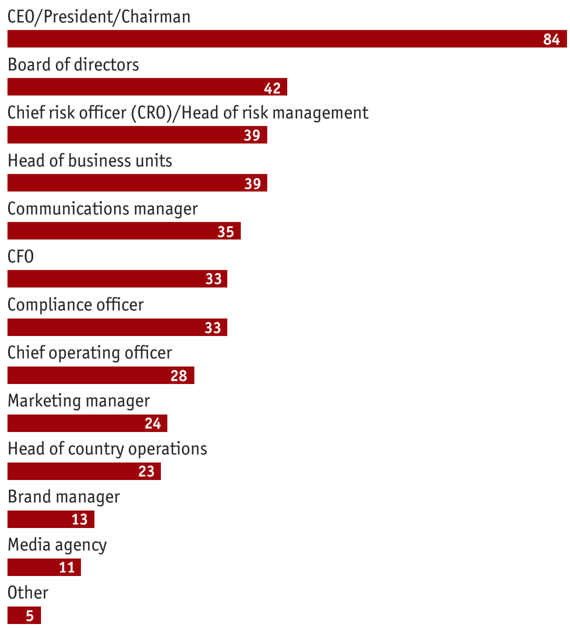
While the role of standard-bearer for the brand belongs to the CEO and the board, many risk managers emphasise the importance that all staff members are aware of their part, and play it fully. According to Artur Damasceno, vice-president of audit at ABN AMRO, "[reducing reputational risk] starts with your personal example as an employee and a citizen." "Everybody should be involved [in protecting reputation], otherwise it would not be sustainable."

The CEO's role in leading this "reputational team" seems pivotal, but some companies reveal doubts about whether anyone is investing sufficient time and resources into reputational risk management in practice. One response in the survey that is particularly revealing is the high level of concern expressed by executives about the fact that no one has taken formal responsibility for reputational risk. This is considered a major obstacle to effective risk management by 39% of respondents, making it one of the biggest barriers to managing reputational risk successfully. It suggests that satisfaction with the current allocation of responsibility is not high.

Room for improvement

The lack of consensus regarding reputational risk management strategies and the shortage of established tools for the job are reflected in the patchy levels of satisfaction expressed by risk managers in their efforts in this area. More than 60% appear happy with their communications with customers, and this matches the priority given above to monitoring customer opinion. A further 33% consider their capabilities in this area to be adequate, and only 7% class them as poor. When it comes to communicating with other stakeholders, the level of satisfaction is markedly lower: 48% declare good capability, 38% adequate and 13% poor. This implies that the lower frequency with which opinion is monitored among these groups, as indicated above, is not through lack

Which of the following have major responsibility for managing reputational risk within your company?
Please check as many as apply.
(% respondents)



Source: Economist Intelligence Unit, 2005

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of desire among risk managers.

Substantial confidence is expressed in organisations' ability to enforce strong controls on governance and compliance. However, when it comes to monitoring threats to reputation, only 51% describe their capabilities as good, while 34% describe them as adequate and 15% as poor—more than for any other area.

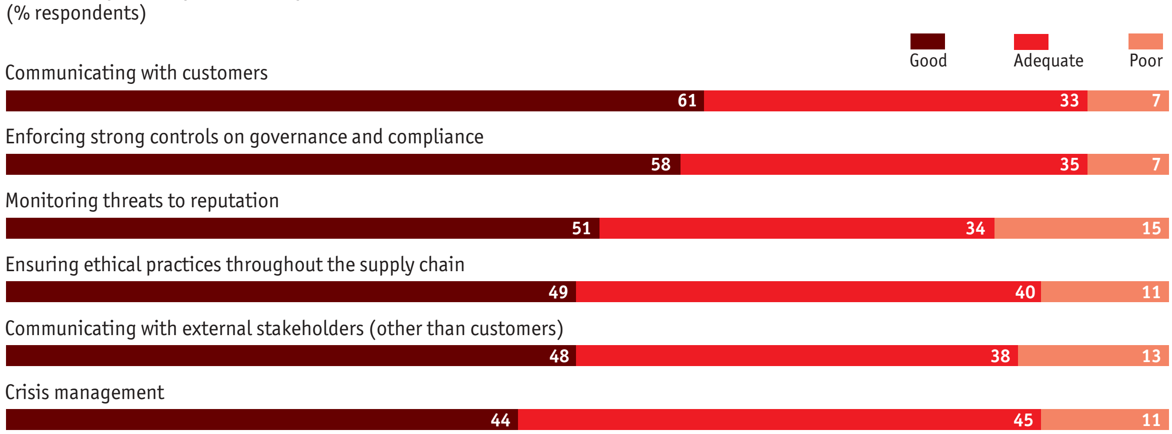
The difficulty of controlling risks to reputation arising from third-party partnerships is reflected in the relatively low level of satisfaction expressed with capabilities to ensure ethical practices throughout the supply chain. This is a particularly elusive area of risk management. Damage to the reputation of a business partner, adviser or auditor can be transferred to the organisation by simple association, and is less easily repaired than the cost of an unpaid bill or an unmet contract. "If their reputation is good, mine is probably good too," says Dr Raghavan.

The lowest level of confidence, despite the emphasis given to it in other questions, concerns the capability to manage crises. Here, those judging their position as good (40%) are outweighed by those with only adequate preparations (45%).

Opinion is divided over whether reputational risk can be quantified. Just over one-half of respondents believe it can, compared with one-quarter who think it cannot. It would be reasonable to expect that those most confident in their ability to express reputational risk in numbers would be from industries such as finance, where a quantitative approach to risk management is well established. In fact, this is not the case. In financial services, 30% consider reputational risk unquantifiable, a larger percentage than in the overall sample. In contrast, within the energy sector two-thirds felt they could quantify reputational threats. Only one in ten said they could not.

Practice suggests that, although methodologies for quantifying reputational risk have been put forward, none has won general acceptance. Methods centre on business managers estimating the losses that would occur in the event of a service failure that rebounded on reputation, normally by ranking them on a simple numerical scale. The results can be consolidated and used as a guide to the allocation of resources. The principle appears sound, but is dogged by difficulties, such as the lack of a database of reputational losses against which judgments can be benchmarked and the difficulty of separating direct losses from the less foreseeable indirect ones (a regulatory sanction is

How would you rate your company's capabilities in the following areas?
(% respondents)



Source: Economist Intelligence Unit, 2005

finite; the reputational fallout is not). Mr Jackson of Fordham University suspects that reputational risk cannot be measured, and denounces “a faction of empirically minded researchers who want to make it [reputational risk] as scientific as possible”. Even so, many risk managers are attempting to at least prioritise, if not precisely quantify, the various threats against their companies reputations.

Conclusion

Opinion is divided as to whether reputational risk is a category of risk in its own right, or merely the consequence of a failure to manage first-tier risks. Whatever position companies take on this, almost all executives agree that corporate reputation is a hugely valuable asset that needs to be protected. It is also clear that serious reputational damage can occur simply as a result of perceived failures, even if those perceptions are not grounded in fact. Understanding how different aspects of an organisation’s activities impinge on stakeholder perceptions is therefore a vital aspect of protecting a company’s reputation.

There are three distinct tasks to managing reputational risk: establishing reputation to begin with, maintaining it through the rough and tumble of business operations, and restoring it when it has been damaged. The latter two, especially, call for very different actions (and actors). Whereas establishing and maintaining reputation may be considered a matter of successful risk control in other areas, reputational repair clearly cannot.

Reputational risk can arise from almost any business failure. As such, it is too important and wide-ranging to belong to any individual or department. The CEO plays the vital co-ordinating role, but must also personify the values and conduct that ensure a company’s good standing. Other members of the reputational risk team include the chief risk officer, who tends to be more focused on the more technical task of monitoring, mitigating and, where possible, quantifying reputational threats. Communications, service and sales staff are involved in mitigating the reputational fallout of everything from a negative news story to a break down in customer service. Above all, good companies create a culture where employees take responsibility for enhancing corporate reputation through their everyday activities. Responsibility for corporate reputation, and the threats that can undermine it, extend from top to bottom in today’s organisations.

Currently, many companies feel that their capabilities in managing reputational risk leave much room for improvement, but the high rewards of success should provide strong motivation for progress in this area. Incurring reputational damage can be fatal, but establishing a robust reputation can provide a strong competitive advantage. A good reputation strengthens market position, reduces the price of capital and increases shareholder value. It insulates the brand, permits higher prices and helps to attract top talent. It protects public companies from unwelcome takeover bids, arms them for M&A forays of their own, and raises the potential returns from share offerings. In times when the issue of trust is under particular scrutiny, these are prizes well worth attaining.

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About the survey

A total of 269 senior risk managers participated in our survey on risk and reputation. The survey was conducted in October 2005, and our thanks are due to all those who shared their time and insights.

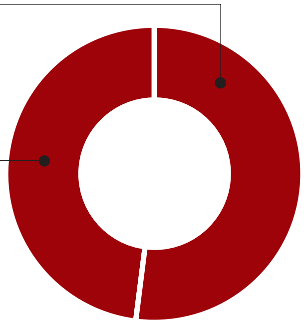
How significant a threat do the following risks pose to your company's global business operation today?
(% respondents, index score, where 100 = highest)

Reputational risk (eg, events that undermine public trust in your products or brand)	52
Regulatory risk (problems caused by new or existing regulations)	41
Human capital risks (eg, skills shortages, succession issues, loss of key personnel)	41
IT network risk (eg, network security breaches, IT systems failure)	35
Market risk (risk that the market value of assets will fall)	32
Credit risk (risk of bad debt)	29
Country risk (problems of operating in a particular location)	22
Financing risk (difficulty raising finance)	21
Terrorism	19
Foreign exchange risk (risk that exchange rates may worsen)	18
Natural hazard risk (eg, hurricanes, earthquakes)	18
Political risk (danger of a change of government)	18
Crime and physical security	15

Do you view threats to your company's reputation as:
(% respondents)

A category of risk in its own right **52**

Something that arises as a consequence of a variety of other risks **48**



How large an impact is each of the following factors likely to have in prompting an increased focus on reputational risk within your company?
(% respondents, large impact, index score, where 100 = highest)

Reputation is becoming a key source of competitive advantage as products/services become less differentiated	59
Faster dissemination of 'bad news' through global media/communication channels	51
Higher standards of governance imposed by regulators	43
Customers readier and more able to switch suppliers than ever	39
Increased willingness of governments to intervene in business on issues of public concern	33
Customers' increased focus on buying from ethical suppliers	26
Increased targeting of companies by pressure groups	24
Other	19

To what extent are the following actions a source of reputational risk for your organisation?
(% respondents)

	Major	Minor
Non-compliance with regulation/legal obligations	66	53
Exposure of unethical practices	58	52
Security breaches (eg, sensitive data leaks, hacking of customer financial data)	57	43
Failure to deliver minimum standards of service and product quality to customers	47	62
Poor crisis management	40	41
Failure to hit financial performance targets	34	25
Risk by association with suppliers, partners, alliances, etc with poor reputations	34	36
Failure to address issues of public concern pro-actively (eg, climate change)	14	24
Environmental breaches	14	25
Labour unrest	11	18
Other	4	9

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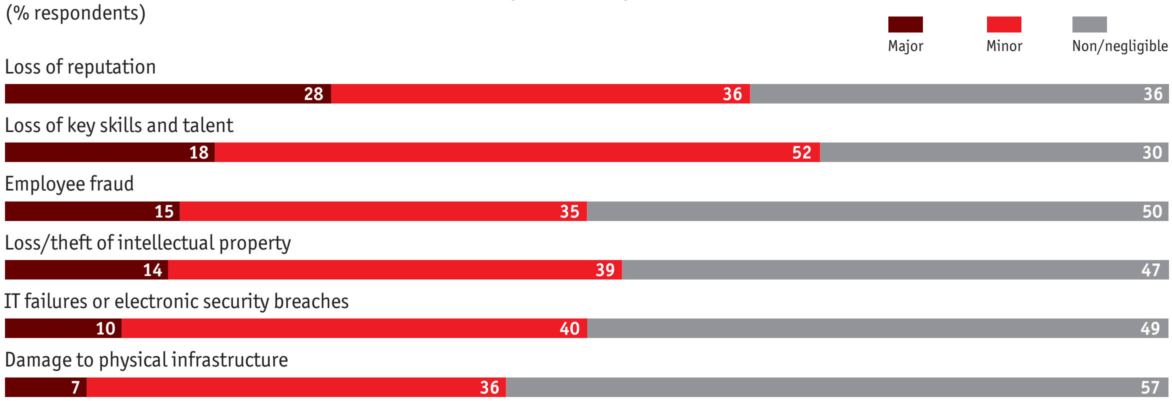
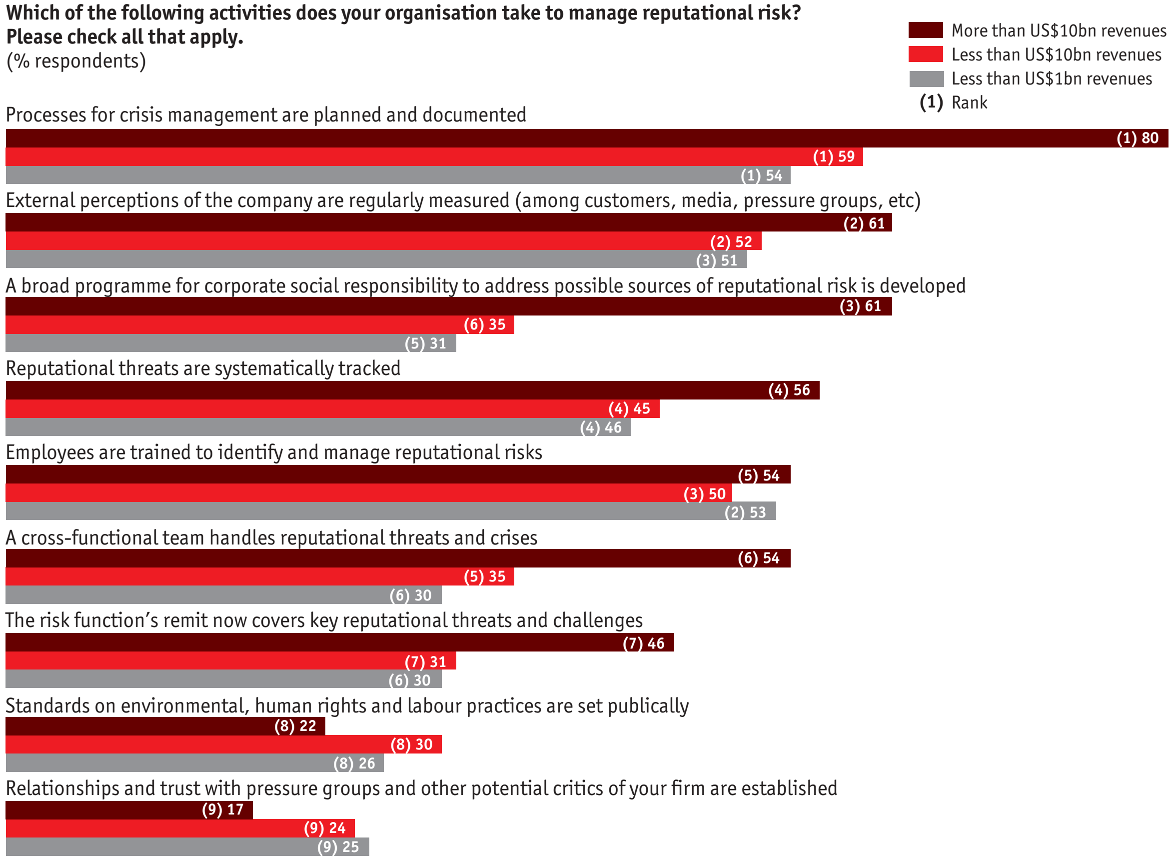
How much damage have the following events inflicted on your company's financial performance in the past?
(% respondents)



Which of the following activities does your organisation take to manage reputational risk? Please check all that apply.
(% respondents)



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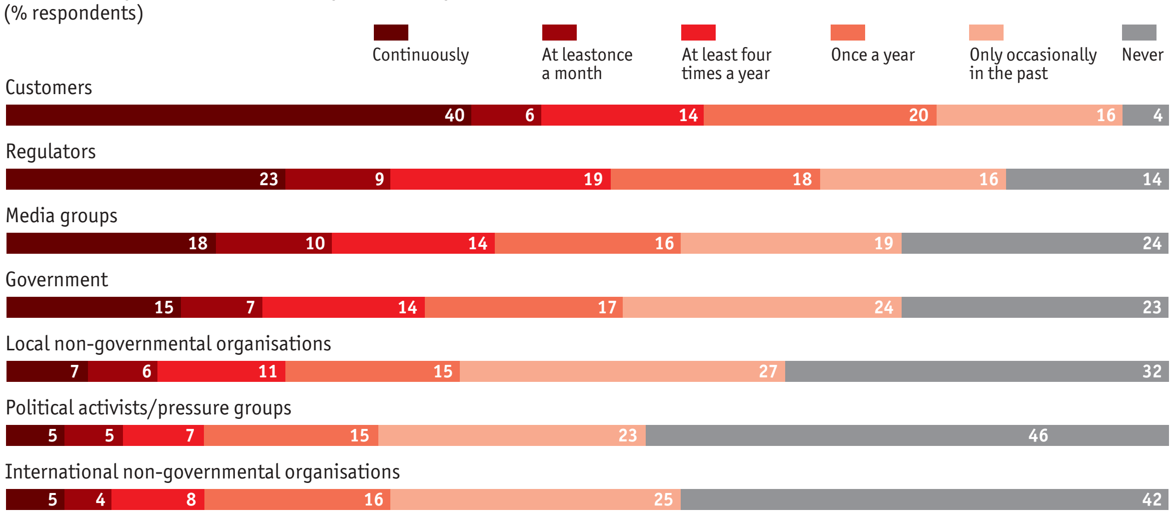
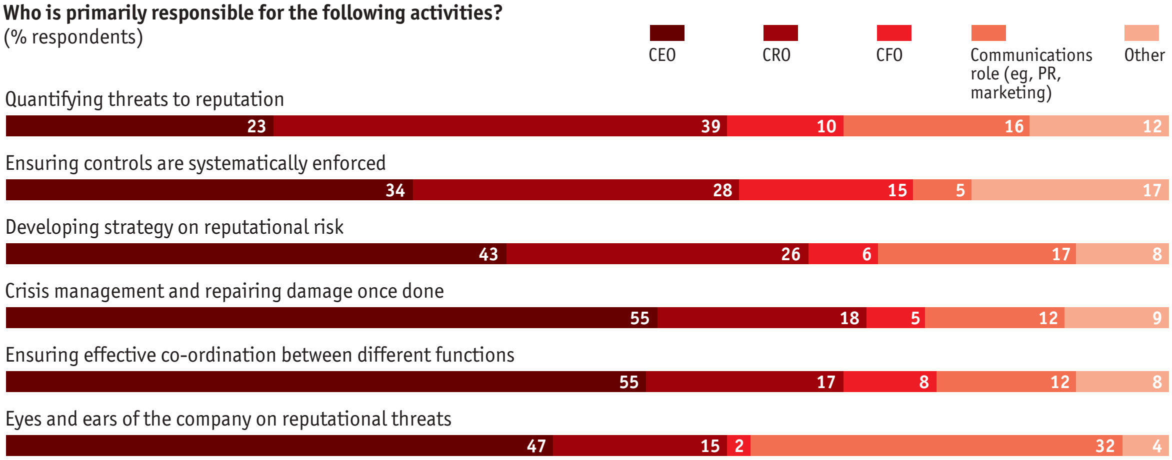
How often do you test perceptions of your company among the following corporate stakeholders?
(% respondents)

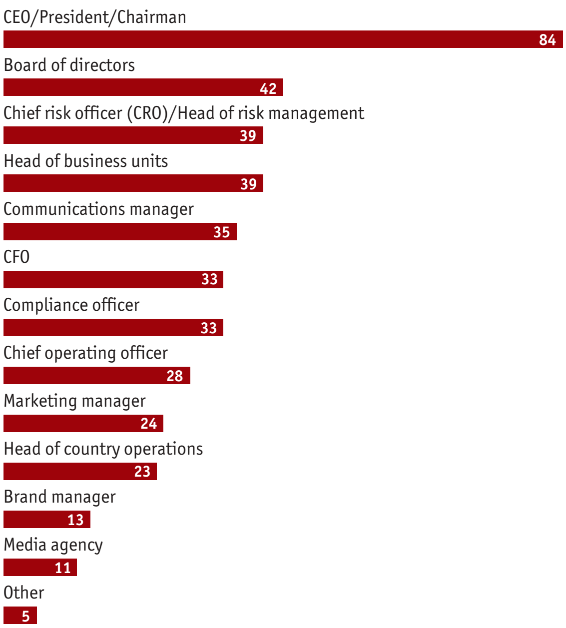


Who is primarily responsible for the following activities?
(% respondents)

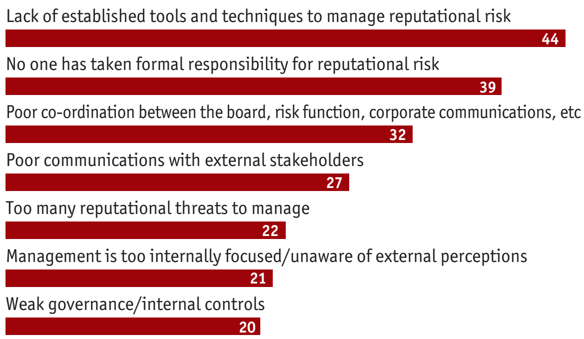


Do you agree or disagree with the following statements?
(% respondents)

Which of the following have major responsibility for managing reputational risk within your company? Please check as many as apply.
(% respondents)



How would you rate each of the following as an obstacle to managing reputational risk in your organisation?
(% respondents, major obstacle)



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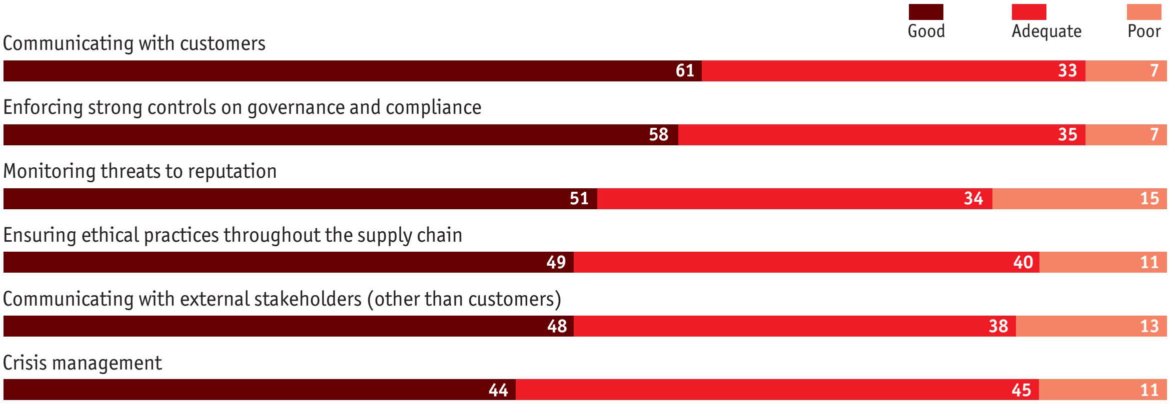
How would you rate your company's capabilities in the following areas?
(% respondents)



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